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IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

No. 371

EDWARD J. McCARTHY and LORA R. McCARTHY,

Petitioners,

—v.—

JOSEPH J. CONLEY, District Director for Internal Revenue for District of Connecticut,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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The Petitioners pray that a writ of Certiorari issue to review the Judgment of the United States Court of Appeals for the Second Circuit entered in the above case on the 23rd day of February 1965.

Opinions Below

The opinion of the District Court for the District of Connecticut is reported at 229 Fed. Supp. 517 (1964). The opinion of the Court of Appeals for the Second Circuit is reported at 341 Fed. 2d 948 (1965).

Jurisdiction

The judgment of the Court of Appeals for the Second Circuit was made and entered on February 23, 1965 (R. 5a-19a). Nine copies of the record as printed by the Court of Appeals for the Second Circuit are filed with this petition under Rule 21(4) of this Court.

On the 24th day of May 1965, Hon. John M. Harlan, Associate Justice of the Supreme Court of the United States ordered that the time for filing the petition for Certiorari herein be extended to and including July 23, 1965.

Question Presented

Does Sec. 267 Internal Revenue Code 1954 prohibit recognition of capital losses incurred by Petitioner, Lora R. McCarthy on a Sec. 302 (a) (b) (3) Internal Revenue Code 1954 redemption of her common stock by the Andrew Radel Oyster Co.?

Statutes, Cases and Regulations Involved

Internal Revenue Code, 1954
Section 267
Section 302 (a) (b) (3)
Section 311
Regulation 1.311-1 (a)
Section 317

Statement

Petitioners brought suit to recover an alleged overpayment of Income Taxes of $23,909.71 with interest, for the Calendar Years, 1954, 1955 and 1956, inclusive.

Petitioners filed their Motion for Summary Judgment on the grounds that said redemption is one under Section 302 (a) (b) (3), Internal Revenue Code of 1954, to which Section 267 does not apply as a matter of law.

Respondent filed his Motion for Summary Judgment on the grounds that there is no issue as to any material fact, and he is entitled to judgment as a matter of law.

The District Court for the District of Connecticut, denied Petitioners' Motion for Summary Judgment, granting Respondent's Motion for Summary Judgment and entered judgment for the Respondent. On appeal by Petitioners to the ~~Circuit~~ Court of Appeals for the Second Circuit, said judgment was affirmed.

After the death of Andrew Radel, Sr., in 1915, his two (2) sons, Andrew Radel, Jr., and J. Louis Radel, took over the operation of the firm; the former as President and Treasurer, and the latter as Vice President and Assistant Treasurer. Subsequent to the death of their mother in 1931, these two (2) sons, together with three (3) sisters, Margaret R. McElroy; Mary R. Keating and Lora R. McCarthy, each owned one-fifth (1/5th) of the outstanding stock of 5000 common shares of the Company. Consequently, it had been agreed between the parties that under the attrition rules of Section 267, the Petitioner, Lora R. McCarthy, owned more than fifty per cent (50%) of the outstanding common stock of The Andrew Radel Oyster Company.

It was this stock which the Company redeemed from the Petitioner, Lora R. McCarthy, in 1954 for $128.00 a share, or a total price of $128,500.00. It is the Petitioner, Lora R. McCarthy's claim that the cost basis of this stock was $361,250.00, and that as a consequence her sale of stock to The Andrew Radel Oyster Company resulted in a loss to her of $234,750.20.

Respondent denied the refund because Section 267 of the Internal Revenue Code of 1954 prohibits the losses claimed on the Petitioners' Return for the redemption of Lora R. McCarthy's common stock by The Andrew Radel Oyster Company, because under the attrition rules of said Section 267, Lora R. McCarthy, owned fifty per cent (50%) or more of the common stock of said Company.

It is agreed between the parties that the cash distribution to Lora R. McCarthy, on the redemption of her stock is not equivalent to a dividend (R. 6a). Consequently, both parties claim that the transaction is a Section 302 (b) (3) redemption, with the Petitioners claiming that Section 267 does not apply, and the Respondent claiming that it does.

Reasons for Granting the Writ

The decision below should be reviewed because it failed to consider Section 267 of the Internal Revenue Code of 1954 *outside of the exception therein,* and whether said Section 267 applies to a redemption under Section 302 (b) (3), Internal Revenue Code of 1954, to the damage of Petitioners.

This is evident from the Court of Appeals' decision, Rec. 15a as follows:

> "We were unable to expand the exclusion on Section 267 to make room for a distribution not essentially

equivalent to a dividend without regard to the definition of 'partial liquidation in Section 346'. We are equally unable to hold that a distribution not essentially equivalent to a dividend standing alone is a 'partial liquidation' within that definition."

"Thus the fact that the distribution received by her was not essentially equivalent to a dividend under Section 302 because it resulted in a complete termination of her interest, has no relevance here."

The above quoted remarks make it obvious that the Court considered Section 267 *within its exception only,* and in connection with Section 346, dealing with partial liquidations.

Nowhere does the Court consider the argument under Section 302 dealt with in Section 1., 11. and 111. of Petitioners' Brief, Record Pages 3-12.

In fact, the Court's opinion shows it misconstrued Petitioners' argument (see Note No. 14, Rec. Page 14a). Petitioners made no such claim as stated in said note. Their claim under Section 267 (d) was on behalf of the Petitioners, and not concerning the Corporation.

Petitioners' claim, as far as Corporation was concerned, is that since a corporation realizes no gain or loss on a redemption (see Section 311, Internal Revenue Code 1954 and Regulation Rec. Pages 50a, 51a, 52a and 53a), and there is no point in making a corporation a person as provided in Section 267 (b) (2) Rec. Page 35a.

Petitioners' claim, as far as Lora R. McCarthy is concerned, is that because she received "money" which was property under Section 317 (a) Internal Revenue Code of 1954 which she could not transfer, there is no transferee

able to obtain the benefit of "retained basis" under Section 267 (d) which is a new provision in the 1954 Code.

Neither of these claims is mentioned in the Court of Appeals' decision.

CONCLUSION

For the reasons above set forth, it is respectfully submitted that this Petition for a Writ of Certiorari, should be granted.

EDWARD P. J. MCCARTHY
Counsel for Petitioners

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APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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APPENDIX

Opinion

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 198—September Term, 1964.

(Argued December 3, 1964 Decided February 23, 1965.)

Docket No. 28965

EDWARD J. McCARTHY and LORA R. McCARTHY,

Plaintiffs-Appellants,

—v.—

JOSEPH J. CONLEY, JR., District Director of Internal Revenue for the District of Connecticut,

Defendant-Appellee.

Before:

FRIENDLY and SMITH, *Circuit Judges,*
and BLUMENFELD, *District Judge.**

Appeal from a judgment of the District Court for the District of Connecticut, T. Emmet Clarie, *Judge,* granting appellee's motion on cross-motions for summary judgment. Opinion below reported at 229 F. Supp. 517. Affirmed.

EDWARD J. McCARTHY, Bridgeport, Connecticut, *for appellants.*

* Sitting by designation.

ROBERT J. GOLTEN, Department of Justice, Washington, D. C. (Louis F. Oberdorfer, Assistant Attorney General, Lee A. Jackson, David O. Walter, Department of Justice, Washington, D. C., Jon O. Newman, United States Attorney, Hartford, Connecticut, F. Owen Eagan, Assistant United States Attorney), *for appellee.*

BLUMENFELD, *District Judge*:

This is an appeal from a summary judgment adverse to the appellant in a suit for refund of income taxes paid to satisfy deficiency assessments for the years 1954, 1955 and 1956. The taxpayer, Mrs. Lora McCarthy,[1] owned 1000 shares of the stock of The Andrew Radel Oyster Company, a family corporation, which she had acquired through inheritance. In December 1954, she sold her shares to the corporation which paid for them with liquid assets it had accumulated out of earnings and profits over a long period. It was the taxpayer's use of a claimed loss on this transaction to offset income for the years in question that the District Director disallowed.

The court below found that there was no genuine issue of fact which would rebut the District Director's determination that the payment made by the corporation for the purchase of her stock was not a distribution in partial liquidation and ruled that the loss deduction was properly disallowed under §267 of the 1954 Code. We agree.

The issues before us have been narrowed somewhat. The government has conceded that the payment received by the taxpayer from the corporation escapes dividend tax treatment as a distribution under §302(b)(3) of the 1954

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1 Mr. McCarthy is a party solely because he filed joint returns with Mrs. McCarthy for the years in question.

Code.[2] The taxpayer has conceded that since her two sisters and her two brothers owned the remaining 4000 outstanding shares of stock, the transaction out of which the claimed loss arose was between related taxpayers as defined in §267(b) and that the recognition of any loss is governed by §267 of the Internal Revenue Code of 1954.

The foundation of the taxpayer's dispute with the District Director lies in that portion of §267 which provides:

"(a) Deductions disallowed.

No deduction shall be allowed—

"(1) Losses.

In respect of losses from sales or exchanges of property (*other than losses in cases of distributions in corporate liquidations*), directly or indirectly, between persons specified within any one of the paragraphs of subsection (b)." (Emphasis added.)

It is taxpayer's contention here, as it was below, that the payment to her by the company constituted a "distribution[s] in corporate liquidation[s]" within the parenthetical exception in §267(a)(1) and, therefore, that the loss was deductible.[3]

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2 "§302. Distributions in redemption of stock.

* * * * *

"(b) Redemptions treated as exchanges.

* * * * *

"(3) Termination of shareholder's interest.

Subsection (a) shall apply if the redemption is in complete redemption of all of the stock of the corporation owned by the shareholder."

3 No case interpreting this exception or its predecessors has been brought to the attention of this court. In fact, we have been able to discover only one case where a similar problem has arisen. In *Estate of Ruth Hanna*, 37 TC 63 (1961), the court, without discussing the exception, denied recognition of a loss resulting from a §302 redemption of stock owned by the estate. The case, however, was reversed in 320 F. 2d 54 (6th Cir. 1963) on the ground that an estate is not a related taxpayer within the meaning of §267.